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Attracting Chinese FDI in Africa: the role of natural resources, market size and institutional quality

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Attracting Chinese FDI in Africa: the role of natural resources, market size and institutional quality

Abstract

Purpose – The study aims to examine the effect of natural resources, market size and five major institutional factors (voice and accountability; political stability and absence of violence; regulatory quality; rule of law; and control of corruption) on Chinese FDI in Africa.

Design/methodology/approach – This study uses regression analysis on panel data across 22 countries for the period from 2008 to 2014.

Findings – Natural resources did not play a significant role in attracting Chinese investments, but market size did. Among the institutional factors, only voice and accountability had a significant and positive effect on attracting Chinese FDI; the effects of rule of law and control of corruption were not significant; and political stability and regulatory quality had a significant and negative effect.

Research limitations/implications – Chinese investment in Africa is only a recent phenomenon, and is growing rapidly, further studies should examine factors that are unique to the context such as bilateral political link.

Practical implications – African countries that are struggling with improving their poor institutional quality in the short term could effectively attract Chinese investment by reducing investor psychic distance, e.g. establishing a closer political link with China. Nevertheless, in the long term measures of improving institutional quality are important.

Originality/value – This study reveals for the first time that what attracts Chinese investment is market size rather than natural resources and different institutional factors of an African country show varying effects on attracting Chinese FDI.

Keywords: Foreign Direct Investment, determinant, China, Africa, natural resources, country risk, cross -country panel data, location

Paper type: Research paper

Introduction

China has become an important player in the global market due to its stable financial presence in recent years, and Chinese outward foreign direct investment (OFDI) has increased steadily. China's OFDI flow to Africa has grown from 317,430 million dollars in 2004 to 2,516 billion dollars in 2012 (Ministry of Commerce of the People's Republic of China, 2013). According to Ernest (2014), between 2007 and 2013, the amount of FDI received from China accounted for 4.2% of Africa's total FDI. Compared with the amount of FDI contributed by other countries, China's contribution to Africa is not large (UAE - 12.1%; UK - 10.7%; US - 8%; India - 7.3%). Within China's OFDI, the African market receives far less than the Asian market (11.5% versus 53.6% in 2014), which suggests that China's FDI to Africa has an enormous potential for growth.¹ African countries currently face three major challenges: slow growth, poverty and inequality (Sundaram, Schwank, & von Armin, 2011). Attracting foreign direct investment (FDI) is important for the African countries to meet these challenges, because not only could it help drive the economic growth directly, but it could also facilitate technology transfer from developed countries (Borensztein, De Gregorio, & Lee, 1998; Kahouli & Maktouf, 2015). Understanding the determinants of Chinese FDI into Africa thus becomes imperative for both theory and policy development.

Empirical studies on the determinants of Chinese OFDI so far show inconsistent or even contradictory results, particularly with regard to the host country factors such as natural resources and institutional quality. Seeking natural resources is seen as the main motive for Chinese OFDI in less developed countries (Cai, 1999), but the

¹ Ministry of Commerce of the People's Republic of China. (2015). *2014 Statistical Bulletin of China's Outward Foreign Direct Investment*. Retrieved from Beijing

empirical evidence is equivocal. Kolstad and Wiig (2012) and Ramasamy, Yeung, and Laforet (2012) show that natural resources were a significant factor for Chinese investment, whereas Blomkvist and Drogendijk (2013), Cheung and Qian (2009) and Blomkvist and Drogendijk (2013) indicate the link was not significant. In Africa, accompanying cheaply available natural resources is often the poor institutional quality (Yang, Wang, Wang, & Yeh, 2017). Good institutional environment and political stability obviously could attract FDI inflow (Dunning, 1982), whilst Bevan and Estrin (2004) indicate that political stability is not an obvious determinant of FDI. Empirical results so far show contradicting evidence regarding institutional factors' influence on Chinese OFDI. Several studies show that Chinese investors are particularly attracted to countries that have abundant natural resources with poor institution quality (eg. Buckley et al., 2007; Kolstad & Wiig, 2012; Ramasamy et al., 2012).

This study therefore focuses on examining the effect of natural resources, market size and institutional factors on attracting Chinese FDI in Africa. The institutional quality includes five major factors: voice and accountability; political stability and absence of violence; regulatory quality; rule of law; and control of corruption (Howell, 2011). These specific institutional factors may have different effect on attracting FDI (Bailey, 2017), therefore we examine them separately rather than in aggregate. Market size is included in our analysis, because it is another key factors of Africa to attract FDI other than natural resources (Asiedu, 2006), and Chinese investment could be driven by the market (Chen, Dollar, & Tang, 2016).

This study makes two major contributions to the literature. First, we reveal that what attracts Chinese investment is market size rather than natural resources. Second, we found that and different institutional factors of an African country show

varying effects on attracting Chinese FDI, from negative, not significant to positive effect. Moreover, unlike previous studies that are based data of short time period and limited sample size (e.g. Kolstad & Wiig, 2012; Ramasamy et al., 2012), we collected data for a relatively longer period from 2008 to 2014, with bigger sized sample that includes 22 African countries. We applied a method suitable for analysing panel date, the fixed-effect model to the panel data of 22 African countries. The remaining of the paper is structured as follows: Section 2 reviews the existing literature on Chinese OFDI, and proposes three hypotheses for empirical test. Section 3 describes the data and methodology; Section 4 presents the estimation results and discussion; and Section 5 concludes.

Literature review and hypotheses

Natural resources and market size

When profit-maximising firms face global competition, FDI is one of the outcomes of their strategic decisions (De Mello, 1999). Several factors may influence a firm's choice of location for investment. As indicated by Dunning (1998), these factors into four main types: market-seeking, resource-seeking, efficiency-seeking and strategic asset-seeking. A country may attract more FDI if it has sufficient market size, abundant natural resources, low-cost labour or materials, or knowledge-related assets (Dunning, 1998). Natural resources and market size are the two factors that have received most attention in the literature on the determinants of FDI in Africa (Asiedu, 2006; Rodriguez-Pose & Cols, 2017).

Previous studies in general indicate that natural resources are positively related to FDI inflow (e.g. Deng, 2004; Hong & Sun, 2006; Naidu, 2007; Ramasamy et al., 2012; Renard, 2011; Sanfilippo, 2010; X. Zhang & Daly, 2011). As for FDI in African countries, Asiedu (2006) shows that natural resources are a significant factor, based on an analysis of panel data over the period 1984–2000. Frynas and Paulo (2007) also highlight that natural resources play a key role for attracting FDI. Using data specific to Chinese outward investment in the period 2003–2006, Kolstad and Wiig (2012) show that the poorer a host country is, the greater the attraction of their natural resources to Chinese investors. However, several researchers do not find evidence to support that seeking natural resources is the main motive of Chinese FDI in Africa. For example, Cheung and Qian (2009) indicate that although both market size and resource endowment are significant drivers of Chinese outward investment in general, but resource-seeking is not the main motivator for Chinese investment in

Africa. Similarly, J. Zhang, Wei, and Liu (2013) show that Chinese private enterprise investors are motivated by Africa's markets rather than its natural resources.

The rapid growth of China's economy in the past 30 years has triggered the country's demand for natural resources has increased dramatically. The Chinese government has encouraged OFDI as a tool to acquire sufficient supply natural resources to support the country's sustained development (Ye, 1992; Zhan, 1995). As Kaplinksy and Morris (2009) argue, the resource-rich Africa is therefore the perfect investment location. Therefore, despite the discrepancies of the previous empirical evidence, it is reasonable to believe that natural resources play an important role in attracting Chinese investment. Thus:

H1: The degree of natural resources of an African country is positively related to China's FDI in that country.

Consistent with the location theory proposed by Dunning (1998), empirical studies overall confirm the positive relationship between market size and FDI inflows. Asiedu (2006) examines data of FDI in Africa and demonstrates that the market size play a key role. Kolstad and Wiig (2012) investigate the determinants of Chinese outward FDI, and show that it is attracted to large markets. Using firm level-data, Chen et al. (2016) show a positive relationship between the market size of a host African country and Chinese FDI inflow. They argue that like all investors, Chinese investors seek profit maximization, thus prefer to invest in countries that have large market size. Thus:

H2: The market size of an African country is positively related to China's FDI in that country.

Voice and accountability

According to Howell (2011), 'voice and accountability' encompasses military involvement in politics and democratic accountability. As noted by Howell (2011), in the long term, a high level of military involvement in politics is likely to lead to an uneasy environment for foreign investors because it can generate corruption in the system of governance and can encourage an armed opposition. Busse and Hefeker (2007) found that there is a negative correlation between military involvement in politics and FDI after analysing a sample of 83 developing countries for the period 1984 to 2003. Cleeve (2012) reports that this is particularly the case in Sub-Saharan African countries.

Howell (2011) defines democratic accountability as how reactive a government is to its people, and explains that a less reactive government is more likely to fall, be it peacefully or violently. Kucera and Principi (2014) report mixed results showing that the effect of democracy varies across the industries. For the service and manufacturing industries, the effect is positive, whereas for the energy industry, it is negative. A few studies report a negative effect of democracy, such as Mathur and Singh (2013). However, most empirical studies report a positive effect of democracy and FDI inflow. For example, Rodrik (1996) found that US companies tend to invest in countries with high democratic accountability. Q. Li and Resnick (2003) also found that an increase in democratic rights can lead to an increase in FDI, although their results may be biased by their limited sample size and restricted sample period (Busse & Hefeker, 2007). Cleeve (2012) also supports this relationship, even if he believes that the result is not always robust. Jensen (2003, 2008) shows that the relationship between fundamental democratic rights and FDI inflow is significant. Rodriguez-Pose

and Cols (2017) refer to ‘voice and accountability’ as an indicator of good governance that helps to attract FDI in Africa. Thus:

H3: Voice and accountability of an African country is positively related to China’s FDI in that country.

Political stability and absence of violence

How political stability can affect the inflow of FDI is another contentious issue which has attracted much attention in previous research (Bevan & Estrin, 2004; Dunning, 1982). Political stability measures how likely the governments of host countries are to be destabilised (Howell, 2011). It can be affected by four main factors: government stability, internal conflict, external conflict and ethnic tensions (Howell, 2011). A higher level of political instability can make the host country less attractive to investors because it is generally associated with higher levels of expropriation, which may worry potential investors (Azzimonti & Sarte, 2007), and impede their commitment to investment (Büthe & Milner, 2008; Dunning, 1982; Schneider & Frey, 1985).

Most scholars find that political instability is negatively related to the inflow of FDI (Cleeve, 2012; Naudé & Krugell, 2007; Qian & Baek, 2011; Ramasamy et al., 2012), with one exception that Kolstad and Wiig (2012) find no significant relationship between political stability and FDI. In other words, the literature is generally agreed that political stability has a positive effect on FDI inflow. Thus:

H4: Political stability and the absence of violence in an African country are positively related to China’s FDI in that country.

Regulatory quality

Regulatory quality measures the risks such as contract viability, profits repatriation, and payment delays (Cleeve, 2012; Gobinda Goswami & Haider, 2014). The degree of regulatory quality determines how likely foreign investors are to receive their proper benefits. Previous studies overall indicate that regulatory quality attracts FDI inflow. For example, Busse and Hefeker (2007) show that investment profile, an important measurement of regulatory quality, is positively related to FDI inflows at the 10% level, meaning the relationship is statistically significant. Chowdhury (2017) shows a significant and positive correlation between the regulatory quality of South Asian countries and FDI inflow. Gani (2007) provides an empirical analysis of 18 developing countries, including China, for the years 1996, 1998, 2000 and 2002, and concludes that the regulatory quality of the host country has a positive influence on the amount of FDI they receive. Cleeve (2012) and Naudé and Krugell (2007) show that there is a positive correlation between investment profile and the inflow of FDI in African countries. However, according to Anyanwu (2012) and J. Li (2014), lower regulatory quality may not hinder Chinese investment, indicating that the effect of regulatory quality could be insignificant. Therefore, an empirical test is required for the following hypothesis:

H5: The regulatory quality of an African country is positively related to China's FDI in that country.

Rule of law

Rule of law indicates the quality of legal systems and contract enforcement (Bailey, 2017). It is often seen as a key factor affecting welfare, stability and growth (Belton, 2005; Haggard, MacIntyre, & Tiede, 2008; Hiil, 2007); Janse, Sanchez Galera, and Liivoja (2007) Strong rule of law provides protection of property rights, reduces transaction costs for foreign firms (Khoury & Peng, 2011). Moreover, strong rule of

law decreases uncertainty and improves firm's efficiency and profitability (Bailey, 2017). On the contrary, a lack of rule of law may lead to the liquidation of current investments, and this can deter potential investors (Hewko, 2002). Previous studies indicate that rule of law in general has a positive effect on the inflow of FDI (Du, Lu, & Tao, 2008; Gani, 2007; Gastanaga, Nugent, & Pashamova, 1998; Khoury & Peng, 2011). Studies that focus on African countries, such as those by Asiedu (2006), Cleeve (2012), Naudé and Krugell (2007) and Anyanwu (2012), also confirm this positive relationship. Thus:

H6: Rule of law in an African country is positively related to the inflow of China's FDI in that country.

Control of corruption

Control of corruption refers to how well host countries can control their corruption level. Corruption causes social uncertainty and can involve hidden costs (Kwok & Tadesse, 2006), which may have an indirect influence on the inflow of FDI. Empirical studies by Egger and Winner (2006), Habib and Zurawicki (2002), Fung and Garcia-Herrero (2012), and Egger and Winner (2005) support this argument. In the context of FDI in Africa, it is also found that high corruption levels deter FDI (Asiedu, 2006; Rogoff & Reinhart, 2003). In the case of China's OFDI to Africa, the empirical study results are mixed. Cheung, De Haan, Qian, and Yu (2012) reveal a negative relationship between corruption and the inflow of FDI. However, Gu (2009) indicates that Chinese investors are not particularly concerned about corruption in the host country. Kolstad and Wiig (2012) explain that Chinese investors have experience of dealing with corruption at home and tend to invest in those countries with similar levels of corruption (Blomkvist & Drogendijk, 2013; Habib & Zurawicki, 2002). Therefore, the following hypothesis requires a further test.

H7: The level of corruption of an African country is negatively related to the inflow of China's FDI in that country.

Data and method

Table 1 presents all the variables used in this study. Table 2 summarises all the explanatory and control variables that this paper uses to test the hypotheses.

[Insert Table 1 about here]

[Insert Table 2 about here]

Dependent variable

The dependent variable is the stock of China's OFDI to the sample of 22 African countries. The data source was Statistical Bulletin of China's Outward Foreign Direct Investment.

Explanatory variables

The main explanatory variables used in this study are: natural resources rent; market size; voice and accountability; political stability and absence of violence; regulatory quality; rule of law; control of corruption; infrastructure index/score; GDP; and trade.

Natural resources. Natural resources are measured using the index of the total natural resources rents (% of GDP) instead of the natural resources reserve in the 22 African countries. As the World Bank explains, to build an analytical framework for sustainable development, the index of natural resources rents - the measurement of the percentage of the contribution of natural resources to economic output - is vital. This index is used because investors tend to be more interested in the profitability of natural resources rather than that of those on the ground (Kolstad & Wiig, 2012). The data of natural resources rents are taken from World Bank databases because 'the group is guided by professional standards in the collection, compilation and dissemination of data to ensure that all data users can have confidence in the quality and integrity of the data produced' (World Bank).

Market size. This study uses GDP as a proxy for market size (Asiedu, 2006; Chen et al., 2016; Kolstad & Wiig, 2012), and the data extracted from the World Bank and the unit used is US dollar.

Voice and accountability. The index of voice and accountability summarises the effect of two factors: military involvement in politics and democratic accountability. The data of voice and accountability for this study are extracted from the International Country Risk Guide (ICRG) by Political Risk Services (PRS). The ICRG, a methodology adopted by the PRS group, has been used by numerous researchers at various organisations, such as IMF (The PRS group).

Political stability and absence of violence. This index includes four elements: government stability, internal conflict, external conflict, and ethnic tensions. The data are drawn from the ICRG by PRS.

Regulatory quality. The data of regulatory quality are extracted from the ICRG by PRS.

Rule of law. This is the measurement of the 'degree to which a country's citizens have confidence in the law and comply with the rules of society' and it focuses on the quality of the host country's legal system (Slangen & Van Tulder, 2009). The data of this index are drawn from the ICRG by PRS.

Control of corruption. The data of this index are also extracted from the ICRG by PRS.

Control variables

Three control variables are included in our estimation, namely inflation, infrastructure and trade. The extant literature suggests that these variables are some of the major relevant factors in attracting FDI.

The first control variable is inflation. Investing in a foreign country with lower inflation rates can gain the investor a competitive advantage (Kleinert & Toubal, 2010). We use the data of the GDP deflator (instead of the Consumer Price Index (CPI)) from the World Bank as a measurement of the inflation level of the 22 African countries being considered. According to Baumol and Blinder (2008) definition, the GDP deflator is 'a broad measure of economy-wide inflation that includes the prices of all goods and services in the economy.' Also, Baumol and Blinder (2008) explain that the GDP deflator can measure overall inflation more successfully than CPI because the former is based on a market basket including all goods and services produced by the economy.

The host country's infrastructure has a great role to play in attracting Chinese FDI, and is thus used as another control variable in this paper. The data of infrastructure index/score is from the Global Competitiveness Report (GCR).

The third control variable used in this study is trade (% of GDP), found by many studies to have a strong correlation with the inflow of China's FDI. Trade measures the percentage of the sum of exports and imports of goods and services in GDP. The data of trade that are collected from the World Bank database.

Considering all the hypotheses, the main estimate equation of this study (including GDP, inflation, trade, infrastructure, voice and accountability, political stability, regulatory quality, rule of law, and control of corruption) is as follows:

$$\begin{aligned}
 \text{China's OFDI stock}_i &= \alpha_i + \beta_1 \text{GDP}_i + \beta_2 \text{INFLATION}_i + \beta_3 \text{TRADE}_i + \beta_4 \text{VA}_i \\
 &+ \beta_5 \text{PV}_i + \beta_6 \text{RQ}_i + \beta_7 \text{RL}_i + \beta_8 \text{CC}_i + \beta_9 \text{NATURAL}_i \\
 &+ \beta_{10} \text{INFRUSTRUCURE}_i + \varepsilon_i
 \end{aligned}$$

As is standard procedure in economic literature, this study applies the natural log transformation to the variables to produce straightforward regression coefficients. After the transformation, the estimate equation reads:

$$\begin{aligned}
 \ln China's\ OFDI\ stock_i &= \alpha_i + \beta_1 \ln GDP + \beta_2 \ln INFLATION_i + \beta_3 \ln TRADE_i \\
 &+ \beta_4 \ln VA_i + \beta_5 \ln PV_i + \beta_6 \ln RQ_i + \beta_7 \ln RL_i + \beta_8 \ln CC_i \\
 &+ \beta_9 \ln NATURAL_i + \beta_{10} \ln INFRASTRUCTURE_i + \varepsilon_i
 \end{aligned}$$

One problem when analysing panel data is high correlation among independent variables, as this may cause multicollinearity. The correlation matrix shows whether the variables are correlated with one another. According to Table 3, those independent variables used in this paper used are not too highly correlated (<0.8). Therefore, multicollinearity should not be a problem for the estimation results and those variables may be used for this paper's regressions.

[Insert Table 3 about here]

Results and discussion

Hausman test. The Hausman Test ascertains whether the fixed-effect or the random-effect model is more appropriate for the estimation. As Table 4 shows, the p value (Prob>chi2) of the Hausman Test is 0.0000, meaning the null hypotheses can be refused. In this instance, the Hausman test deems the fixed-effect model to be the more appropriate one.

[Insert Table 4 about here]

Table 5 presents the main results from the regression of China's outward FDI stock with the fixed-effect model, using six explanatory variables and four control variables. The Coef column shows the estimation coefficient for the equation. Also, the R-sq (0.77) shows that the fitted regression line is very close to the actual data.

[Insert Table 5 about here]

Natural resources. The results as shown in Table 5 show that natural resources are not significantly related to China's OFDI in Africa between 2008 and 2014. It suggests that seeking natural resources are not the main motivator for Chinese investors. Those countries with greater quantities of natural resources may necessarily attract more of China's FDI. The result fails to support H1. However, it is in line with the findings by Cheung and Qian (2009), J. Zhang et al. (2013), and Blomkvist and Drogendijk (2013). It is in contrast with the findings by Wells (1983), Yamakawa, Peng, and Deeds (2008), Buckley et al. (2007), Kolstad and Wiig (2012), and Ramasamy et al. (2012).

Market size. The result indicate that GDP and infrastructure, are strongly and significantly related to Chinese FDI, supporting H2. The finding suggests that

Chinese investors are motivated by the market size and they prefer to invest in countries with less developed infrastructure. The results are not surprising as on the one hand, big market size indicating greater opportunities for investors. The finding is consistent with previous studies (Asiedu, 2006; Chen et al., 2016; Dunning, 1998; Kolstad & Wiig, 2012).

Voice and accountability. The regression result shows a significant and positive relationship between the voice and accountability of the 22 host countries and China's OFDI stock, thus H3 was supported. The result is in line with the findings from most previous studies. For example, Busse and Hefeker (2007), Rodrik (1996), Cleeve (2012), Kucera and Principi (2014), and Q. Li and Resnick (2003) agree that an increase in a country's voice and accountability may lead to an increased inflow of Chinese FDI.

Political stability and absence of violence. The result shows that political stability and absence of violence have a significant and negative relationship with China's OFDI in Africa. Thus, H4 was not supported. This suggests that countries with greater political instability are more attractive to Chinese investors. This finding is different from those of Büthe and Milner (2008), Dunning (1982), Schneider and Frey (1985), Azzimonti and Sarte (2007), and Kolstad and Wiig (2012). The coefficient is significant at the 10% level indicating that the negative correlation between political stability and China's FDI flow to Africa is relatively high. The reason for this negative effect is probably is a political one, in that those political unstable African countries and China may have bi-lateral political agreements that help reduce the risks of Chinese investment (Qian & Baek, 2011).

Regulatory quality. The estimation results indicate that regulatory quality of the has a significant negative influence on inward FDI flow from China (significance at

the 5% level). Thus, H5 was not supported. The results contradicts many previous empirical studies, such as those by Busse and Hefeker (2007), Cleeve (2012), Naudé and Krugell (2007) and Gani (2007) who report a positive relationship between regulatory quality and FDI. However, this result is in line with the findings of Anyanwu (2012) and J. Li (2014) that the lower regulatory quality does not hinder China's OFDI, because of Chinese investors' psychic distance. As Blomkvist and Drogendijk (2013) point out, Chinese investors prefer to invest in countries with a similar cultural, economic and political environment. According to the data from the World Bank, in 2015, China's regulatory quality index is 44, which is close to that held by Africa (30).

Rule of law. The result indicate that the relationship between rule of law and the flow of FDI from China was insignificant. Thus, H6 was not supported. It seems that when choosing investment destination countries in Africa, Chinese investors do not pay too much attention to the rule of law rating of host countries. This result is consistent with the findings of Daude and Stein (2007), but contradicts to those of Asiedu (2004); Gani (2007); Asiedu (2006); Anyanwu (2012) and Cleeve (2012) that there is a positive relationship between the two factors. This result does not support Slangen and Van Tulder (2009) and Naudé and Krugell (2007) who argue that rule of law is negatively correlated with the FDI inflow from China.

Control of corruption. The results show that control of corruption does not a significant relationship with Chinese FDI. Thus H7 was not supported. This contradicts the results of Wheeler and Mody (1992), Fung and Garcia-Herrero (2012), Egger and Winner (2005), and Habib and Zurawicki (2002) that control of corruption has a positive effect on inward FDI. This result is also surprisingly different from many empirical studies with a focus on Africa such as Asiedu (2006) and Rogoff and

Reinhart (2003). However, it is in agreement with Gu (2009), who claims that China is not overly concerned with the corruption level of FDI host countries. It may be that China's own unusually high level of corruption (for a developed country) makes Chinese investors sympathetic to other countries with corrupt governments, or at least means that the prospect of corruption is not frightening (Kolstad & Wiig, 2012).

Control Variables. The result indicate that infrastructure has a negative relationship with Chinese FDI, which suggests that Chinese investors are motivated to invest in countries with less developed infrastructure, this is not surprising as many of Chinese investments are on infrastructure development projects. The other two variables the inflation rate and the trade index' relationships with Chinese OFDI were insignificant.

Conclusions

This study attempts to uncover the factors that attract Chinese FDI in Africa, with a focus on natural resources, market size and institutional factors including voice and accountability, political stability, regulatory quality, rule of law, and control of corruption. A regression model was run on the panel data of 22 countries for the period from 2008 to 2014, with four other factors as control variables, namely, inflation, infrastructure and trade. The results show that what attracts Chinese FDI in Africa is a host country's market size rather than its natural resources. [\[elaborate a bit more on this\]](#)

Institutional factors of an African country show three different effects on attracting Chinese FDI. First, the study reveals surprising results that political stability and regulatory quality are negatively related to the Chinese OFDI. It is counterintuitive that Chinese investors prefer to invest in a politically unstable country. The reason for that could be the presence of a strong political relations between the politically unstable country and China, as suggested by Qian and Baek (2011). When choosing the destination of investments, many Chinese investors are often driven by political reasons, particularly large state-owned companies.

Second, the rule of law and control of corruption have no significant effect on China's OFDI. This suggests Chinese investors are not particularly concerned about weak legal systems or occupation in a host country. The reason for this could be due to the weak institutional factors at home country. Chinese managers have the expertise of coping with those weak institutional factors. The above findings imply that for those African countries that are struggling with improving their poor institutional quality in the short term, they could still effectively attract Chinese

investment by reducing investor psychic distance, e.g. establishing a closer political link with China.

Third, voice and accountability exerts a significant positive impact on the inflow of China's FDI to Africa. This is an encouraging sign, as it implies that African countries that strive to increase their voice and accountability, could attract more of China's FDI. We could expect that in the long term, as the institution quality in China gradually improves, Chinese investors still prefer to invest in a country with good institutional quality.

This study is limited to the data that Chinese investment in Africa is only a recent phenomenon, and the volume is relatively small compared to FDI from the developed countries. Nevertheless, the room for the growth of Chinese FDI in Africa is enormous. Further studies should examine the factors that are unique to the context such as bilateral political link between an African country and China.

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